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A cash flow analysis approach to privatisation : case study of Klaipeda Stevedoring Company

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A CASH FLOW ANALYSIS APPROACH TO PRIVATISATION: CASE STUDY OF KLAIPĖDA STEVEDORING COMPANY

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DECLARATION

I certify that all the material in this dissertation that is not my own work has been identified, and that no material is included for which a degree has previously been conferred on me.

The contents of this dissertation reflect my own personal views, and are not necessarily endorsed by the University.

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ABSTRACT

Title of Dissertation**:**

A cash flow analysis approach to privatisation: a case study of Klaipėda Stevedoring Company

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This dissertation focuses on the financial resource management, and in particular, cash flow management.

The research is based on a case study of Klaipėda Stevedoring Company and it covers a three year period when the company was preparing for privatisation.

The author looks at the cash flow statements and tries to assess which of the areas of activity are most significant to the company's cash flow.

The changes in the amount of inventory, the credit given to customers or taken from suppliers and its impact on cash flow are examined.

The relationship between the current assets and current liabilities are explored by looking at movements that have taken place within the working capital of the firm.

For a better view, time factor was considered in a cash cycle, and assessment of the efficiency of the company's credit policies was analysed.

This analysis helps to see how the company was managing its cash flows through investment in inventory, credit provided to customers and credit taken from suppliers. The faster cash circulation through the business the lower is the amount of the capital tied up in operating assets and, as every time the cash completes the circuit a profit is taken, the higher is the rate of return achieved.

The concluding chapter evaluates the cash flow management in a period the company was in transition. Giving a view to the actions taken and their effect on the company's financial position, pinpointing areas of future concern. The author has made a number of recommendations in regard to the need for future improvement in the subject.

KEYWORDS: Cash flow, current assets, current liabilities, working capital, liquidity

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LIST OF ABBRIVIATIONS AND SYMBOLS

ADC	Average daily costs
ADS	Average daily sales
d.	Day/days
KLASCO	Klaipėda Stevedoring Company
Lt.	Litas, currency of the republic of Lithuanian
USD	Dollar, currency of the United States of America
--------	No data; illogical
1996-1998	From 1996 to 1998 inclusive

CHAPTER 1

Introduction

1.1. The aim and scope of the study

Globalisation and privatisation processes, which have taken place during the last decade, have led to increasingly fierce competition in the port industry throughout the world. As a result, they have added tremendously to the pressure on port managers who face a continuous challenge of enhancing and sustaining their organisations' competitive advantage.

Traditionally, to deal with competition, port managers focused their attention on operational performance, neglecting another very important side of business management - finance. However, the financial resources management could also make a difference and be an effective tool in striving to attain a competitive advantage.

The paradox is that, although it is widely recognised that finance management is a useful tool in achieving business goals, managers still rarely use it. The reason for this is the typical belief that finances belong to an area which is difficult to understand and requires specialist skills.

Partially this is true. Nevertheless, the changing business environment requires port managers to have an integrated knowledge and skills and therefore the ability to understand, interpret and use the information provided in financial statements.

The author of this dissertation focuses on one particular aspect of financial resources management, that is cash flow management.

Cash flow is a very important financial concept. Every activity of any company is translated into cash at some time. Cash is used to pay employees and suppliers, to make investments into assets, pay dividends to providers of financial resources and for many other purposes. No business can continue once it has an insufficient cash balance. However, too much cash, as an idle resource, might be wasteful and indicate that the company is not operating as profitably as it could be.

Therefore, understanding and managing cash flows in a proper way not only could allow a company to survive, but also allow it to increase its profitability and achieve the flexibility needed to take advantage of unexpected business opportunities, hence increasing its competitive potential.

This dissertation is based on an analysis of the cash flows in Klaipėda Stevedoring Company (hereinafter referred to as KLASCO).

KLASCO is the biggest stevedoring company in Lithuania. Having monopolised the market for a long time as a state corporation, it handles more than fifty percent of the cargo throughput through the only Lithuanian seaport, Klaipėda.

The company consists of three parts: General Cargo Port, International Ferry Terminal and a Container Terminal. The container terminal was opened in January

1999 and remains the only developed specialised container terminal on the eastern coast of the Baltic Sea.

It is the author's conviction that this research is a unique opportunity to show how the financial resource management could change a business situation. For this purpose the author has chosen a very dramatic and exciting moment in the life of the company during its preparation for privatisation. The company was privatised at the beginning of 1999.

1.2. Methodology and encountered difficulties

This dissertation is a case study of cash flow management in Klaipėda Stevedoring Company covering a three-year period before privatisation (1996-1998). The study has been developed through the analysis of the financial statements collected from the company.

In addition to materials collected from the company, the author made research from journals, periodicals, books and Internet sources. Data was also collected from seminars and lectures conveyed at the World Maritime University as well as oral interviews from relevant persons during field studies. Computer spreadsheets were used where necessary to make comparisons and trend analyses of statistical data.

Although the study was successful, the author was faced with difficulties finding a sound basis for comparison of the received financial performance ratios, such as liquidity, inventory turnover and/or length of the working capital cycle. Most stevedoring companies approached for information failed to assist in availing their financial statements, which in their view was deemed to be their competitive edge. For the companies that provided information, the author felt that the financial ratios provided were not satisfactory for inter-company comparison of stevedoring

companies because of the differences in their functional responsibilities and financial structures.

1.3. Structure of the dissertation

Chapter 1 is a general introduction of the study. Here the author presents his view about the importance of financial resource management in attaining a competitive advantage and defines the area, scope and methodology of the analysis.

As a starting point for assessing the company's financial situation before privatisation, the author looks at the company's cash balances between the years 1996 and 1998 and examines changes occurring in that period. This is covered in *Chapter 2*.

Chapter 3 tries to get a better view of the company's financial position by expanding the scope of analysis to cover all current assets and current liabilities. A look is taken at the changes in what is commonly called the working capital of the company.

Chapter 4 assesses the changes in the company's liquidity.

The adequacy of the company's credit policies is considered in analysing the cash cycle in *Chapter 5*.

In order to cover all financial moves and to get a full picture of the transformations, which took the place before the privatisation of the company, a comparative statement analysis is made in *Chapter 6*.

The last chapter provides an overview of the work and draws conclusions.

CHAPTER 2

Changes in the cash position of the company

2.1. Introduction

As a starting point for assessing changes in the financial position of the Klaipėda Stevedoring Company before privatisation, we will look at the amounts of cash held by the company in the period between the years 1996 and 1998. For the purpose of the financial analysis we define the term cash as all money and bank balances which the company had readily available for immediate use.

We will examine what has happened to the firm's cash resources during that time and will look at different factors which affected the situation. In particular we will concentrate our attention on cash generated from operations, strategic cash outflows for investments, and the external financing of the company. In order to do that we will compare three cash flow statements representing the mentioned period.

The scrutiny of cash flow statement is necessary because all data recorded in the profit and loss account is on an accrual basis; therefore it cannot be used for the analysis of changes in cash flow. Separately, the cash flow statement allows such analysis because it deals only with cash movements during the year; anything else is ignored.

An examination of the cash balances of the enterprise will provide us with the initial insight into the privatisation of the company and will lay grounds for the better understanding of these particular actions and steps which were undertaken by the management at that time.

Now let us walk through the company's cash flow statement.

2.2. The Statement of Cash Flows

The cash flow statement tracks the movement of cash through the business over a period of time. It records all the company's transactions that use cash or supply cash. It shows:

- cash on hand at the start of a period;
- cash received in the period;
- cash spent in the period;
- cash on hand at the end of the period.

Typically, the cash flow statement is divided into sections with cash flows shown according to the activity giving rise to them. According to the accounting regulations passed by the Supreme Council, the Government and the Ministry of Finance of the Republic of Lithuania, all cash movements are classified under four main headings (see Appendix 1):

- Cash flow from operating activities;
- Cash flow from investing activities;
- Cash flow from financial activities;
- Cash flow from extraordinary activities.

At the end of the statement there is a section which indicates changes in the cash held position and shows cash at the beginning and at the end of the financial period.

2.2.1. Cash flow from operating activities

Cash flow from operating activities is the main indicator of the business. It enables the enterprise to compare its maintenance and development level to its working capacity. It shows the company's ability to cover debts, pay out dividends, and make investments from its own sources. In another words - it allows us to follow the cash involved in the company's core business operations.

During the preparation of the cash flow statement, cash flow from operating activities is calculated by adjusting the current year result (profit or loss) with the following amounts (see Table 2.1):

- the influence of non-monetary items on tangible long-term assets, amortisation of intangible assets, changes in stocks, changes in the amount of provisions, changes in the exchange rates, and so on. (according to the regulations if the amounts of the items mentioned above are small, they are joined into one item *Depreciation and amortisation expenses*);
- the influence of changes in amounts payable and receivable involving settlements with clients and suppliers;
- the influence of taxes and other amounts payable to the Government budget;
- the influence of changes in prepayments;
- the result from financial and investment activities, because these activities are reflected separately in appropriate items.

These adjustments to net income are needed to "un-accrue" the effects of the income statement. A positive number means cash is being "added back" to net profit (or loss)

where the income statement had deducted it, and vice versa for a negative number. The bottom-line result is net cash from operations.

Table 2.1: Net cash flow from operating activities (1996 - 1998)

No.	Items	1996	1997	1998
		Lt.	Lt.	Lt.
I.1.	Net profit (-loss)	24.357.823	20.586.324	16.281.783
I.2.	Depreciation and amortisation expenses	30.387.240	29.930.232	28.145.169
I.3.	Negative (-positive) influence of changes in exchange rate of foreign currency	0	-164.954	473.101
I.4.	Losses (-gain) on disposal of long term assets	0	-89.057	-607.935
I.5.	Decrease (-increase) in trade receivables	-537.211	-7.375.364	-1.796.475
I.6.	Increase (-decrease) in trade payables	-328.240	-243.439	19.234.721
I.7.	Increase (-decrease) in accrued liabilities	-2.528.530	320.872	-2.229.831
I.8.	Increase (-decrease) in amount payable to Government and authorities	4.372.083	-4.692.587	302.349
I.9.	Decrease (-increase) in prepayments	-10.916.013	-8.614.883	12.902.190
I.10.	Losses (-gain) from financial and investing activities	-21.778.078	-17.570.648	-12.107.746
	Net cash flow from operating activities (+/-)	**23.029.074**	**12.086.496**	**60.597.326**

Source: KLASCO

Note: All the financial data is provided in the national currency litas (Lt.). Exchange rate 4 Lt. = 1 USD.

As we can see from Table 2.1 the company had a very unstable net cash flow from operating activities. In the year 1996 net cash flow was 23 million Lt., in 1997 only 12 millions, but in 1998 it increased and was more than 60 million Lt.. These numbers seem to be a little bit odd because the level of cash directly generated by the operations of the company (it is expressed in the net profit without any deduction for depreciation and represents a rough indication of the cash flow being generated by the enterprise during the year) was in constant decline (see Figure 2.1).
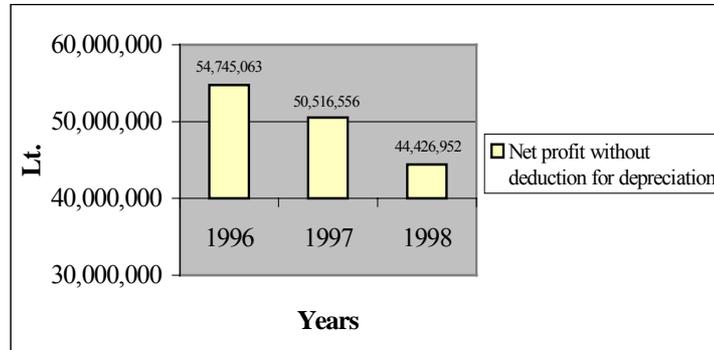
Figure 2.1: Net profit without deduction for depreciation (1996-1998)

Source: KLASCO

In order to understand why there was such a big difference between the result in the years 1996, 1997 and 1998 we have to look at net cash flow from operating activities a little bit closer.

First of all what we can see is a huge change in the trade payables area (see Figure 2.2). During the year 1998 it increased by more than 19 million Lt..
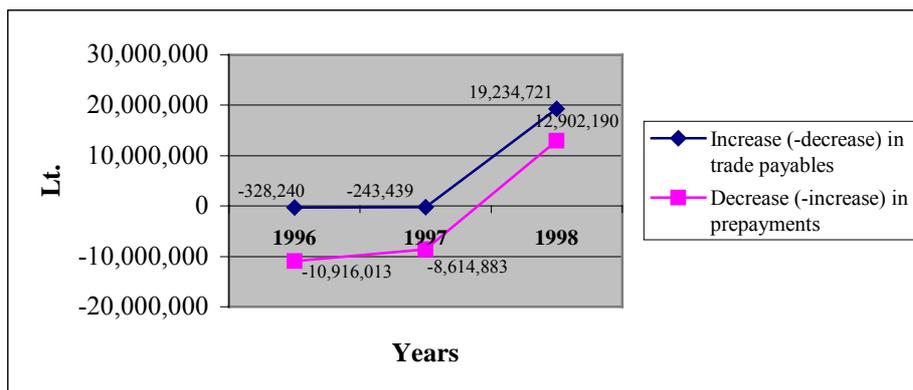
Figure 2.2: Changes in trade payables and prepayments (1996-1998)

Source: KLASCO

Second, there was an even bigger change in the prepayments area (Figure 2.2). They decreased. The difference between the year 1997 and the last year before the privatisation (1998) was almost 20 million Lt..

Combined together these changes allowed the company to free around 40 millions of cash from operating activities.

This indicates that it must been a shift in the company's credit policy in 1998. The assumption is also supported by another point - the change in the level of trade receivables (see Figure 2.3).
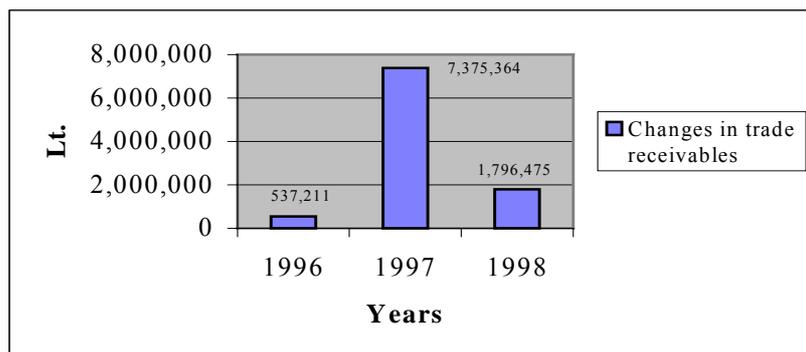
Figure 2.3: Changes in trade receivables (1996-1998)

Source: KLASCO

However, in that case we have to agree that it is difficult to distinguish a stable pattern of cash flows because the situation has changed every year. Nevertheless, the decrease in trade receivables amounts shows that the company probably has tightened its control in that area.

2.2.2. Cash flow from investment activities

Investment activities are second in importance to operating activities. They usually
involve large amounts of money and represent strategic cash outflows paid in the current
period that will earn revenue in forthcoming periods. Cash flow from investment
activities include:

- cash paid in acquiring tangible and intangible long-term assets;
- cash paid for acquiring various securities;
- cash received from disposal of tangible and intangible long-term assets (except for
  assets purchased for resale);
- cash received from sales of securities (except for securities purchased for resale).

According to the Lithuanian accounting regulations the item *Cash flow from disposal of
investments* also reflects dividends received by the enterprise during the accounting
period. If the latter is significant - it could be reported separately (Pačiolis, 1995, p. 95).

Table 2.2 shows how much the company has spent on capital expenditures in our
analysed period. These were investments that KLASCO was making for the purpose of
building its business. As we can see, especially big expenses were made in the year 1998
(line II.1.).

Table 2.2: Cash flow from investment activities (1996 - 1998)

No.	Items	1996	1997	1998
		Lt.	Lt.	Lt.
II.1.	Sales (-purchases) of long-term assets	-38.850.401	-17.728.729	-106.131.962
II.2.	Sales (-purchases) of investments	-5.994.582	8.000.000	-1.051.096
	Net cash flow from investment activities (+/-)	**-44.844.983**	**-9.728.729**	**-107.183.058**

Source: KLASCO

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The problem with the cash flow statement is that it indicates only the total amounts spent on fixed assets but does not disclose in any detail where or on what the cash was spent. However, we know that during the analysed period a new container terminal was built. The construction of it started on November 21st, 1997. The terminal entered into service on January 22nd, 1999. The information about this event is disclosed in the company's Internet web site (www.klasco.lt). It explains the large cash outflows in the year 1998.

Items in line II.2 are simply movements of cash and represent money paid for acquiring and selling various securities. Such movements of cash are not as significant as the capital expenditures. Therefore, we are not going to analyse them in more detail.

2.2.3. Cash flow from financing activities

The third section of the cash flow statement is financing activities. It includes:
- cash received from owners for issuing all types of shares and capital securities;
- cash received from creditors, from issuing bonds, bills of exchange and other securities;
- cash received from credit institutions, when the company's debts increase;
- other cash received from the enterprise's financial activities (e.g. interest received);
- cash paid to owners in the form of dividends; cash paid to owners for repurchase of shares;
- cash paid to credit institutions for interest accrued and repayment of loans;
- cash paid to other companies;
- other cash paid.

In other words, cash flow from financial activities shows the company's relations with third parties, and how successful the enterprise was in using external financing sources.

Table 2.3: Cash flow from financing activities (1996 - 1998)

No.	Items	1996	1997	1998
		Lt.	Lt.	Lt.
III.1.	Issue of preferred and common shares	0	0	0
III.2.	Purchase of own shares (-)	0	0	0
III.3.	Issue of bonds	0	0	0
III.4.	Payments of leasing commitments (-)	0	0	0
III.5.	Increase (-decrease) in bank loans	0	7.500.000	34.400.000
III.6.	Other enterprises:	0	0	0
III.6.1.	Increase (-decrease) in amounts payable	0	0	0
III.6.2.	Decrease (-increase) in amounts receivable	0	0	0
III.7.	Dividends paid (-)	-67.526	-4.514.461	-3.927.886
III.8.	Other cash inflow (-outflow)	0	0	0
	Net cash flow from financing activities (+/-)	**-67.526**	**2.985.539**	**30.472.114**

Source: KLASCO

This is probably the least significant of the three analysed sections, because a business rarely receives cash from these sources more than once or twice a year. Nevertheless it provides some interesting information.

As we can see from table 2.3, starting in the year 1997 the company was using external financing to support its activities. During the year 1998 the size of the loans increased dramatically, they went from 7,5 to 34,4 million Lt. (see Figure 2.4).
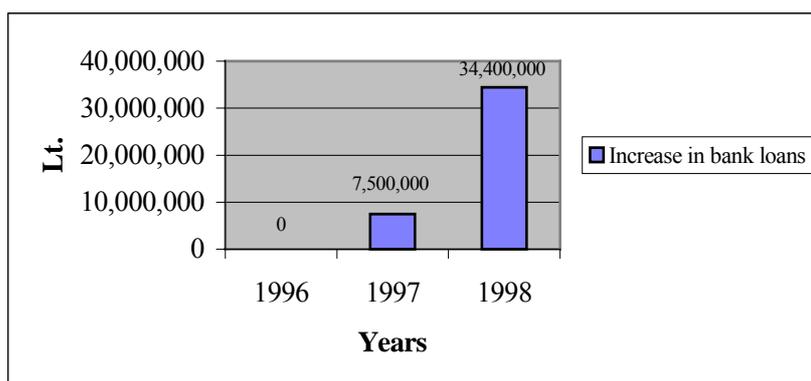
Figure 2.4: Increase in bank loans (1996-1998)

Source: KLASCO

An interesting point is that around 60% of the cash inflow received as a loan in the year 1997 can be compared with the 4,5 million Lt. cash outflow paid as dividends in the same year. The fact that a bigger part of the loan may have been used to pay dividends raises a question about the adequacy of the financial resource management within the firm.

In order to get a better insight into the financial resource management and to determine the company's actual need for external financing, we will compare the size of taken loans to the company's self-financing capability.

2.2.3.1 The company's self financing capability

The ability of the company to finance itself can be assessed by linking its cash inflows directly generated by the operations to its annual cash outflows for capital expenditures. The received ratio is called a self-financing ratio and is expressed in the formula:

Self-financing ratio = (Net income +Depreciation)/ Annual capital expenditure.

The data for the ratio is provided in the first two parts of the cash flow statement (see Table 2.1, lines I.1. and I.2.; Table 2.2, line II.1.)

Table 2.4: Self-financing ratio (1996 - 1998)

No.	Items	1996	1997	1998	Yearly average
I.1.	Net profit (Lt.)	24,357,823	20,586,324	16,281,783	20,408,643
I.2.	Depreciation and amortization expenses (Lt.)	30,387,240	29,930,232	28,145,169	29,487,547
II.1.	Capital expenditures (Lt.)	38,850,401	17,728,729	106,131,962	54,237,031
	Self-financing ratio	**141%**	**285%**	**42%**	**92%**

Source: KLASCO

The received self-financing ratio (see Table 2.4) shows that during the analysed period the company was quite sufficient in terms of ability to support its investment needs. Cash inflows generated by the direct operational activities of the enterprise in the years 1996 and 1997 exceeded its strategic cash outflows by 41% and 185% accordingly. Therefore, theoretically, in these years there was no need for the company to have external financing.

In the year 1998 the cash inflows were 58% less than the strategic outflows. Therefore, in this year loans are justifiable. However, it is still problematic to say how big the loans had to be. The problem with the cash flow statement is that it doesn't provide a full information about the other financial sources, which were available for the company at that time. Nevertheless, according to the self-financing ratio the need for the additional financing had to be low because the surplus accumulated in the first two years during the analysed period, had lowered the need from 58% to only 8% (see average figure in Table 2.4).

Now let us look at the fourth part of the cash flow statement.

2.2.4. Cash flow from extraordinary activities

The fourth part of the cash flow statement represents cash flow from extraordinary activities.

Business is likely at some time to experience some sort of exceptional or extraordinary events. It could be a major reorganisation of the company (for example, as a consequence of the privatisation), which would result in significant cash outflows to cover redundancy payments or the cost of closing or relocating operating units. It is suggested by the regulations that such cash flows should be reported separately,

eliminating their influence on the enterprise's investment and financial activities. But it could be that the cash outflows would be shown under the operating activities or the capital expenditure headings. A common practise is to show just the net cash movement as part of operating activities with additional details in the accompanying notes.

In our case there are no amounts disclosed in that part of the cash flow statement therefore we will leave that section as it is.

2.3. Changes in cash balances

Below is the final portion of the cash flow statement (see Table 2.5). This final section sums up the cash flows from the four sub-sections and thus reconciles the cash balances from one period to the next. The 19,3 millions showed at the bottom-right corner of Table 2.5 is the amount of cash that exists at the end of our analysed period, and that is the amount which appears on the company's 1998 year balance sheet.

Table 2.5: Changes in cash balances (1996 - 1998)

No.	Items	1996	1997	1998
	Increase (-decrease) of net cash flow	-21.883.435	5.343.306	-16.113.618
VI.	Cash at the beginning of the period	51.903.913	30.020.478	35.363.784
VII.	Cash at the end of the period	30.020.478	35.363.784	19.250.166

Source: KLASCO

As we can see the cash balances of the company have decreased significantly. In a period from the beginning of 1996 to the end of 1998 they diminished by more than 60% (from 51,9 million to 19,3 million). Nevertheless the company still had a lot of cash on hand and therefore the size of taken loans, which were disclosed in section 2.2.3 of this chapter and scrutinised in sub-section 2.2.3.1 seems to be inappropriate.

2.4 Conclusions

In this chapter we looked at the amounts of cash held by the company in the period between the years 1996 and 1998. For this purpose we have examined three cash flow statements representing that period. We have seen changes in the net cash flow from operating, investment, and financing activities, and changes in cash balances of the company in general. Now, our findings allow us to draw preliminary conclusions about the financial situation and the financial management in KLASCO before privatisation.

The financial situation of the company was quite stable and similar during the first two analysed years (1996 and 1997), but in 1998 it had changed dramatically. Large amounts of cash were released, mainly due to the increase in trade payables and the decrease in prepayments areas. More than 106 million Lt. were invested into long-term assets. Around 34 million Lt. of loans were taken from the credit institutions.

The big changes in the trade payables and prepayments areas signify a positive attempt by the company to use suppliers' financial resources to support its business needs. Nevertheless, the efficiency of the financial resource management in KLASCO has to be questioned and that is mainly due to the need for the loan in the year 1997 and the size of the loan taken in the year 1998. We will come back to this topic later when we will look at the sources and uses of the funds in *Chapter 6*.

A decrease in the cash balances of the company (see Table 2.5) could be taken as a sign representing a decrease in liquidity, which is an important indicator of the company's short-term financial viability and shows the company's ability to pay its short term obligations as they fall due. However, before we will be able to make any statement about it we have to examine the components of the liquidity. These are the current assets and current liabilities of the firm. The difference between current assets and current

liabilities are commonly called net current assets or working capital of a firm. Therefore, in the next chapter we will concentrate our attention on the changes in the company's working capital.

CHAPTER 3

Working capital analysis

3.1. Introduction

The statement of cash flow gave us an idea where the company's cash came from and where the company spent it. But, to consider only the movement of cash over a period of time does not provide sufficient basis for understanding the financial changes the business has experienced.

To get a better view of the company's financial position before privatisation we have to look at the changes which have occurred within the working capital of the firm. These changes are important indicators of the business performance. They represent changes in the amounts of money the enterprise had to work with in the short-term and give a rough idea about the ability of the company to meet its current obligations as they fall due. In other words – it gives a crude indication about the liquidity of the company.

We already mentioned that the working capital is expressed as the difference between current assets and current liabilities of an enterprise. Therefore, in order to understand how changes in the working capital had affected the company's ability to finance its operations and its liquidity we have to look at and examine the changes in the current assets and the current liabilities of the company.

First, we will start by looking at the current assets and their effect on the working capital. Next, we will examine the changes in the current liabilities and how they influenced the working capital of the firm.

3.2. Current Assets

Current assets are one of the major components of the balance sheet. They are the assets, which can be easily converted into cash within a fairly short time. It is from current assets that a company funds its day-to-day operations. If there is a shortfall in the current assets, then the company has to look for other forms of short-term funding. Such a situation usually results in borrowings from banks, which in return means interest payments and depreciation of shareholders' value.

In Lithuania regulations state that the balance sheet should distinguish four main kinds of current assets (see Appendix 2):
- cash and equivalents
- short-term investments
- accounts receivable
- inventories and prepaid expenses

We will look at each of them and will try to understand how they influenced changes in the current assets and, consequently, the working capital of the firm during our analysed period.

3.2.1. Cash and equivalents

Cash is the most liquid asset of a company. It consists of money and bank balances. Cash is immediately available for a company to pay creditors or make investments. It is possible to distinguish three main motives why companies keep cash: for

transaction, precaution and speculation purposes. We know that a stevedoring business is not the kind of activity were speculations are common. Such a feature is more related to a shipping sector where big amounts of cash change hands very often as ships are bought and sold. Therefore, in our case the transactions and the precautionary motives should, ideally, dictate the appropriate size of the company's cash and bank balances. Thus the important aspect of the internal financial management of the company is to have the right amount of cash available at any time, because too much money is wasteful; too little is dangerous.

In *Chapter 2* we looked at the cash balances of the company before the privatisation. We will look at them once again in *Chapter 4*, when we will analyse the liquidity ratios and in *Chapter 7*, when we will look at the defensive interval of the company. From what we have seen so far it is difficult to say how adequate the size of the cash balances was in the analysed period. However, in terms of the current assets, which we analyse now, we could conclude that the decline in the cash represents a decline of the current assets, as well.

Now, let us look at other parts of the current assets.

3.2.2. Short-term investments

Short-term investments are a step below cash and equivalents. These normally come into play when a company has so much cash on hand that it can afford to tie some of it up in short-term marketable securities with duration of less than one year. This money cannot be immediately liquefied without some effort, but it does earn a higher return than cash by itself. For the financial analysis purposes they are treated as being as liquid as cash.

As we can see from table 3.1 in the year 1996 the company had invested 8 millions into short term securities. The cash flow statement reflects that it collected this money in the year 1997. In the following years there were no more investments.

Table 3.1: Short-term investments (1996-1998)

No.	Item	1996	1997	1998
III.	Short-term investments (Lt.)	8,000,000	0	0

Source: KLASCO

We could assume that the investment in the year 1996 is an expression of a clear cash surplus, which the company had at that time. The absence of such investments in the following years shows that the company had used this money for some purposes, probably invested into inventory or tangible assets. Therefore, we could say that in terms of short-term investments, the company's current assets had declined too.

3.2.3. Accounts receivable

The short-term accounts receivable are used to describe the money that is currently owed to a company by its debtors. It is expected that the company will receive these moneys within 12 months. The reason why such debts arise is that the customers have not paid for the provided services yet, which is not an uncommon situation. Companies routinely buy goods and services from other companies using credit. In our case the stevedoring company extends a credit to its customers for the cargo handling operations and warehousing services. Although it is expected that customers will pay within a fairly short time there are instances where the company has to write-off accounts receivable for bad debt accounts, because it has given credit to someone who cannot or will not pay.

According to the regulations, short-term accounts receivable in the balance sheet are presented under two headings:

- trade debtors
- other amounts receivable

Trade debtors are used to account for debts related to operational activities of the company. Other accounts receivable signify debts which could arise from selling assets of the enterprise on credit, excess tax amounts to be transferred to the government budget or other activities, not related to the operations. Let us look at both categories.

Table 3.2: Changes in accounts receivable (1996-1998)

No.	Item	1996	1997	1998
II.	**Amounts receivable within one year (Lt.)**	**51.553.044**	**41.374.807**	**39.702.931**
II.1.	Trade debtors (Lt.)	13.624.062	20.999.426	22.381.817
II.2.	Other amounts receivable (Lt.)	37.928.982	20.375.381	17.321.114

Source: KLASCO

Table 3.2 shows that the credit extended to the trade partners was continuously increasing. In the year 1998 it reached more than 22 million Lt. On the other hand other amounts receivable were constantly decreasing. All together in the period 1996 and 1998 the accounts receivable of the company declined by 23%. It means that the management of the firm does put in some efforts to secure cash resources of the company.

The decrease in accounts receivable represent a decrease in the current assets of the company.

Later, in *Chapter 5*, we will look at accounts receivable turnover as another way to measure accounts receivables, but now let us move to the inventories.

3.2.4. Inventories

The least liquid of the company's current assets is inventory. The inventory account is used to show stocks of the enterprise. This account is debited when raw materials, supplies and consumables are purchased and credited after consumption or sale of supplies and raw materials in form of services.

It is important to distinguish prepayments and contracts in progress from the rest of inventory, because these are the inventories which have not reached a tangible form yet. Prepayments are money the company has paid in the current period for goods or services to be received in a following accounting period. Contracts in progress are used to account for the value of construction or other contracts in progress.

From Table 3.3 we can see that prepayments and contracts in progress have no big influence on the total amount of the inventories. Therefore, for our future analysis we will use only the figures representing the total amount of inventories.

Table 3.3: Changes in inventories level (1996-1998)

No.	Item	1996	1997	1998
I.	**Inventories (Lt.)**	**28.513.114**	**29.499.042**	**28.312.616**
I.1.	Stocks (Lt.)	28.414.841	29.499.042	28.312.616
I.1.1.	Raw materials and consumables (Lt.)	28.414.841	29.172.282	27.669.484
I.1.2.	Work in progress (Lt.)	0	0	0
I.1.3.	Finished products (Lt.)	0	0	0
I.1.4.	Goods purchased for resale (Lt.)	0	0	0
I.1.5.	Immovable property intended for resale(Lt.)	0	0	0
I.1.6.	Prepayments (Lt.)	0	326.760	643.132
I.2.	Contracts in progress (Lt.)	98.273	0	0

Source: KLASCO

As we can see the level of inventories during our analysed period remains more or less the same. It has almost no influence on the total amount of the accounts receivable.

3.2.5. Changes in the current assets

We have looked at different components of the current assets. Analysis showed us that almost all of them had declined. It consequently affected the total amount of the current assets of the company. From the year 1996 to the year 1998 they diminished by almost 26% (see Figure 3.1).
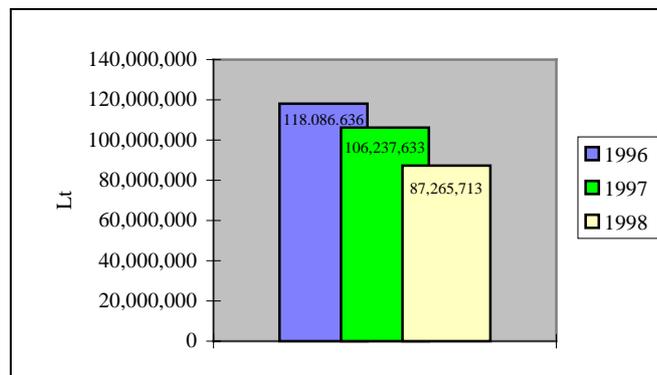
Figure 3.1: Changes in the current assets (1996-1998)

Source: KLASCO

Now let us look at the changes which occurred within the current liabilities of the company.

3.3. Current liabilities

Current liabilities or accounts payable is the money that the company currently owes to its suppliers, its partners and its employees. Basically, these are the basic costs of doing business that a company, for whatever reason, has not paid off yet.

The Lithuanian accounting regulations distinguish six main categories of current liabilities in the balance sheet (see Appendix 2):
- current portion of long-term debts
- financial short-term debts

- trade creditors payable within one year

- prepayments received on contracts in progress

- taxes, remuneration and social security costs

- other amounts payable within one year and short-term liabilities

Not all of them have affected the position of the company during our analysed period. No expenses were associated with the current portion of long-term debts; financial short-term debts; or prepayments received on contracts in progress. Therefore, we will leave them and will concentrate our attention only on trade creditors, remuneration and social security costs, and other amounts payable within one year. We will look at how these three categories have influenced the current liabilities and, consequently, the working capital of the company.

3.3.1. Trade creditors

The account of trade creditors payable within one year is used to show the short-term trading debts payable within one year. This account is debited when paying off trading debts for suppliers'; repurchasing previously issued bills of exchange and returning customers' cash guarantees. The account is credited when entering into new trading debts related to the acquisition of supplies, raw materials and consumables, issuing bills of exchange for goods acquired as well as receiving cash guarantees from customers.

Table 3.4 shows that the level of trade creditors has gone up rapidly in the year 1998.

Table 3.4: Changes in the trade creditors level (1996-1998)

No.	Item	1996	1997	1998
II.3.	**Trade creditors (Lt.)**	**2.377.013**	**2.133.574**	**19.675.815**
II.3.1.	Suppliers (Lt.)	2.377.013	2.133.574	19.675.815
II.3.2.	Bills of exchange payable (Lt.)	0	0	0

Source: KLASCO

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Such a radical change in the amounts owed to the creditors could be interpreted in two ways:

- either the company was running out of resources and therefore it went into debt to its suppliers;

- or, changes in the company's financial policy towards a more aggressive use of suppliers' financial resources.

The use of the suppliers' financial resources is considered to be a good financial management practise because it allows the company to have a credit, usually interest-free, which can be used to finance its operations.

An increase in the trade creditors in 1998 resulted into huge growth in the total accounts payable of the company. It means that the current liabilities had increased.

Now, let us look how the other two categories have influenced the total amount of the current liabilities.

3.3.2. Taxes, remuneration and social security costs

Taxes, remuneration and social security costs used to show the debts related to profit, VAT, social security taxes, taxes deducted from salaries and other similar obligations. This account is used to calculate the debt of the enterprise to the employees as well.

Table 3.5. Changes in the taxes, remuneration and social security level (1996-1998)

No.	Item	1996	1997	1998
II.5.	Taxes, remuneration and social security payable (Lt.)	7.897.905	1.875.360	1.660.431
II.5.1.	Taxes (Lt.)	4.820.401	127.814	174.535
II.5.2.	Remuneration (Lt.)	2.097.471	1.747.546	1.485.896
II.5.3.	Social security payable (Lt.)	980.033	0	0

Source: KLASCO

Table 3.5 shows that the company has been quite successful in reducing taxes paid to the Government. In the year 1996 the amount paid to the authorities was close to 5 million Lt. but in the following two years it went dramatically down to just one hundred twenty seven – one hundred seventy four thousands Lt.. Mainly, such a decrease was possible due to new regulations, which allowed companies to hide taxes payable under plans for future investments.

3.3.3. Other amounts payable

Other amounts payable within one year represent short-term liabilities used to account for debts related to dividends, securities, entitlements and other short-term payable amounts not accounted in other accounts.

Table 3.6: Changes in the other amounts payable (1996-1998)

No.	Item	1996	1997	1998
II.6.	Other amounts payable and short-term liabilities (Lt.)	2.376.092	4.026.922	2.058.741

Source: KLASCO

Table 3.6 shows us that other amounts payable remained more or less the same during our analysed period. There was an increase in the year 1997 but in general it has not affected the total amount of current liabilities at the end of the period because in the year 1998 the level of the other amounts payable went down.

3.3.4. Changes in the current liabilities

We have covered different parts of the current liabilities of the company and now, we could sum up our findings. The results are shown below in Figure 3.2.
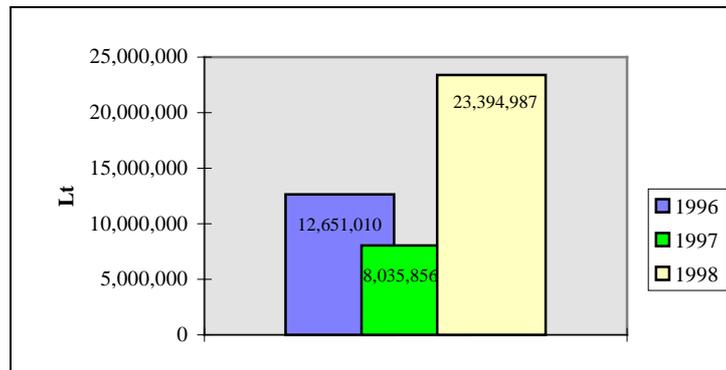
Figure 3.2: Changes in the current liabilities (1996-1998)

Source: KLASCO

As we can see a general trend indicates that the current liabilities have increased. It means that eventually the company was becoming more and more dependent on its creditors. There has been an especially big increase in the current liabilities in the last year before the privatisation. They went up by almost 50%.

3.4. Changes in the working capital

Now, after we have looked at the changes that occurred within the current assets and the current liabilities of the company, we could better understand how these changes have influenced the working capital of the firm.

As we know, during our analysed period the current assets of the company have decreased and the current liabilities went up. Automatically it had an effect on the working capital and liquidity of the company, because, as was mentioned above, it is expressed as the difference between the current assets and the current liabilities.

From Table 3.7 we can see that the working capital of the company has decreased from 105 million Lt. in the year 1996 to 63 million Lt. in 1998.

Table 3.7: Changes in the working capital of the company (1996-1998)

Item	1996	1997	1998
Current assets (Lt.)	118,086,636	106,237,633	87,265,713
Current liabilities (Lt.)	12,651,010	8,035,856	23,394,987
Working capital (Lt.)	**105,435,626**	**98,201,777**	**63,870,726**

Source: KLASCO

In order to understand how the decrease in working capital has affected the company's ability to finance its operations we have to relate it to the sales revenues.

3.4.1. Working capital to sales ratio

The working capital to sales ratio provides an insight into the adequacy and consistency of the working capital management within the firm. For this measure we will ignore cash and investments (Vause, 1999, p. 176). Such step will allow us to see in more precise how much of the company's financial resources were tied up in the current assets in order to maintain a constant level of operations. The ratio is expressed in an equation:

$$\text{Working capital to sales ratio} = \frac{\text{Working capital without cash and equivalents}}{\text{Sales revenues}} \times 100\%$$

Table 3.8: Working capital to sales revenue ratio (1996-1998)

Item \Year	1996	1997	1998
Current assets without cash and equivalents (Lt.)	80,066,158	70,873,849	68,015,547
Current liabilities (Lt.)	12,651,010	8,035,856	23,394,987
Working capital without cash and equivalents (Lt.)	67,415,148	62,837,993	44,620,560
Sales revenues (Lt.)	182,908,238	179,437,517	163,831,390
Working capital to sales revenue ratio (Lt.)	**36.9%**	**35.0%**	**27.2%**

Source: KLASCO

As a general rule, the lower the percentage shown for this ratio is the better it is for a business. For example, it shows that in the year 1998 in order to increase turnover by one million Lt. the company needed an additional 272,000 Lt. and it was much lower

than in the two previous years (see Table 3.8). However, the decrease in the working capital might also indicate that the company was over-stretching its financial resources and might be trying to finance too high level of trading with too little working capital. Such a phenomenon is called overtrading.

3.5. Conclusions

We looked at the changes that occurred within the current assets and the current liabilities of the company. We have seen how it affected the working capital of the firm. It was in constant decline.

As the working capital represents a crude measure of liquidity, we could conclude that during the analysed period the liquidity of the company was declining too. Such a situation raises a question whether the liquidity of the firm was becoming too low and because of that it was necessary to sell the company as soon as possible. In order to answer this question we will examine the company's liquidity in more detail in *Chapter 4*.

The decline in the working capital also indicates a decline in the amounts of money the enterprise had to work with in the short term. We looked at it in Section 3.4.1 of this chapter. Our findings allow us to conclude that, in general, a substantial decrease in amounts of money needed to support the business operations in the year 1998 could be taken as a positive sign of the financial resource management. Nevertheless, it could also indicate that the company was over-stretching its financial capabilities or in other words - overtrading.

We will come back to the analysis of the adequacy of the working capital in *Chapter 5*.

CHAPTER 4

Changes in the liquidity of the company

4.1. Introduction

In *Chapter 2* and *Chapter 3* we have looked at changes in the cash position and the working capital of the Klaipėda Stevedoring Company before privatisation. The analysis of changes has shown a decline in the amounts of money that the enterprise had to work with. We mentioned that this decline could be taken as a sign representing a decrease in the company's ability to pay its short-term obligations, or in other words - liquidity.

In this chapter we will look at the liquidity in more detail. For this purpose we will relate the company's current assets and current liabilities into liquidity ratios.

The first step will be to relate the total current assets to the total current liabilities of the company in what is commonly termed as the current ratio.

The next step – to eliminate the inventories from the current assets and relate the rest to the current liabilities in the liquid or quick ratio.

The third step – to exclude the inventories and the accounts receivable from the current assets and compare the cash balances and the short-term investments to the company's current liabilities.

Such an approach to the analysis of the company's ability to pay its short-term obligations is necessary due to the different liquidity levels of the current assets' components. As was pointed out in *Chapter 3*, the most liquid assets of the company are money and equivalents, they are followed by the short-term investments, then the accounts receivable, and finally the inventories. Thus, the more liquid the company is the higher proportion of its current assets will be in cash or near-cash items.

Now, let us look at the situation of KLASCO.

4.2. Current ratio

The current ratio measures the ability of a business to meet its short-term liabilities in general. It compares the total amount of current assets to the total amount of current liabilities and is expressed by the formula:

Current ratio = current assets/ current liabilities

If this ratio is less than 1:1 it indicates that the business will probably have difficulty meeting its debts in the short term.

A ratio between 1:1 and 2:1 indicates that the business should be able to meet its short-term debts but may not have available working capital to do things such as increase stocks or to cover any trading losses.

A ratio above 2 indicates that the company should be able to pay its debts and have available working capital for other uses.

Now, let us examine the situation with our company.

Table 4.1: Changes in the current ratio (1996 - 1998)

Item \Years	1996	1997	1998
Current assets (Lt.)	118.086.636	106.237.633	87.265.713
Current liabilities (Lt.)	12.651.010	8.035.856	23.394.987
Current ratio	**9,3**	**13,2**	**3,7**

Source: KLASCO

As we can see from Table 4.1 the current ratio of KLASCO was very high during the analysed period. In the year 1996 it was at a level of 9,3; in 1997 at 13,2. In 1998 the ratio had dropped to 3,7, but still, the company had almost four times the amount of total current assets as it had liabilities. It means that in the year 1998 if the company would have had to repay its short-term obligations in full it would have had to liquidate its current assets only at about 25% of their book value.

Although the analysed ratio is obviously very high it fails to provide a clear picture about the liquidity of the company. As we already mentioned, to look at the total amounts of the current assets in the balance sheet is not sufficient, because of different liquidity levels of the current assets' components. Therefore, the next step is to eliminate the least liquid component of the current assets and to see how the situation would change. The new ratio is called liquid or quick ratio.

4.3. Quick ratio

The quick or liquid ratio takes a closer look at the firm's liquidity. It is like the current ratio but measures the company's immediate ability to pay debts. The difference between the two is that the quick ratio subtracts the inventory, as the least liquid asset, from the total amount of the current assets and compares the resulting figure to the total current liabilities. The reason why inventory is excluded is that it often proves to be difficult to turn quickly into cash.

The quick ratio is expressed by the formula:

Quick ratio = (current assets - inventory)/ current liabilities

If the value of this ratio is much less than 1:1 it indicates that the firm might have a liquidity problem, as it may have insufficient assets to meet all its immediate liabilities.

A quick ratio of 1:1 and above indicates that a company should have enough liquid resources to be able to meet all of its current obligations almost immediately.

Now, let us consider the situation with our analysed company.

First of all, we eliminate the inventory, which as we can see from Table 4.2 was a continuously increasing portion of the current assets, although the amount was relatively stable.

Table 4.2: Changes in the inventory holding level (1996 - 1998)

Item \Year	1996	1997	1998
Inventory (Lt.)	28,513,114	29,499,042	28,312,616
Current assets (Lt.)	118,086,636	106,237,633	87,265,713
Inventory holding (%)	**24%**	**28%**	**32%**

Source: KLASCO

Next, we compare the resulting figure of the current assets to the total current liabilities (see Table 4.3).

Table 4.3: Changes in the quick ratio (1996 - 1998)

Item \Years	1996	1997	1998
Current assets without the inventory (Lt.)	89.573.522	76.738.591	58.953.097
Current liabilities (Lt.)	12.651.010	8.035.856	23.394.987
Quick ratio	**7,1**	**9,5**	**2,5**

Source: KLASCO

Once again the liquidity ratio is quite high. Although in the year 1998 it was at the lowest level (2,5), the company still had more than two times in liquid assets than it had current liabilities. It shows that even when inventory was excluded, the company had enough financial resources to pay its debts.

A more strict approach to the liquidity, apart from excluding the inventories, is to eliminate trade receivables from the current assets and compare what is called the most liquid resources of the company - cash balances and short term investments to the total current liabilities.

4.4. Cash and short term investments to the total current liabilities ratio

Although both of the analysed ratios show that the liquidity of the company was high, and in many cases this fact would be acceptable as sufficient evidence of the company's ability to meet its short term obligations, for the purpose of the financial analysis we took one more step ahead. Apart from inventories we eliminated the trade receivables from the current assets and compared what is called the most liquid resources of the company - cash balances and short term investments to the total current liabilities (see Figure 4.1).

The idea behind such a move is that a part of the accounts receivable could be regarded as representing bad, difficult to recover, debts. Knowing circumstances surrounding the business, that up to 70% of cargo going trough the company is transit traffic to or from Russia and that the economical situation in that region is not very stable, it could be considered as a reasonable approach.

The author has no information to what extent the accounts receivable were uncollectable. However, an increase in the amounts owed by trade debtors (see Table 4.4) indicates that such problems might have existed.

Table 4.4: Increase in trade debtors (1996 - 1998)

Item \Year	1996	1997	1998
Trade debtors (Lt.)	13.624.062	20.999.426	22.381.817

Source: KLASCO

If the level of bad debts in the accounts receivable indeed was high, the high liquidity ratios of the company would be justifiable. However, the comparison of cash balances and short-term investments to the total current liabilities (see Figure 4.1) reveals that even if the inventories and the accounts receivable would not be available, the company still had enough financial resources to cover its short-term obligations.
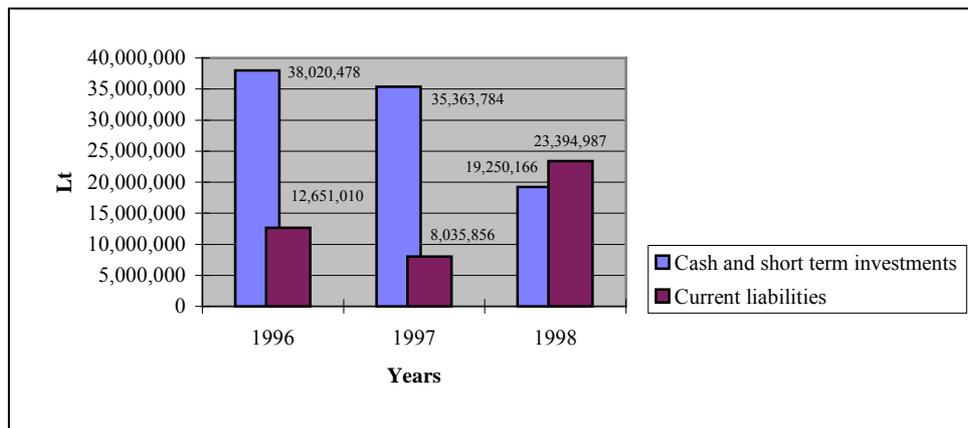
Figure 4.1: Comparison of cash balances to current liabilities (1996 - 1998)
Source: KLASCO

The results shown in Figure 4.1 confirm that the company was highly liquid during the entire analysed period and was able to repay its current liabilities almost immediately.

4.5. Conclusions

In this chapter we examined the liquidity of KLASCO.

In order to get a thorough insight into the company's ability to meet short-term obligations, we eliminated one by one the least liquid assets from the current assets and compared the rest to the total short-term liabilities.

Now, we can answer the question raised at the end of *Chapter 3*, whether the liquidity of the firm was becoming too low.

The result of the analysis allows us to draw a conclusion that the company was too liquid during the analysed period. It was able to repay its short-term debts immediately just from its cash balances. Such a situation shouldn't be considered as healthy. Therefore, a sharp decrease in the liquidity ratios during the year 1998 (see Figure 4.2) should be considered as a positive change in the company's financial position.
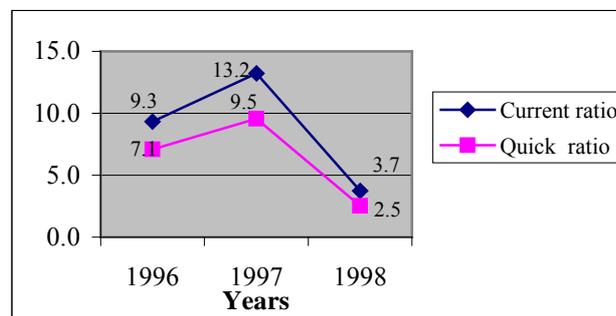
Figure 4.2: Evolution of the current and quick ratio (1996 - 1998)

Source: KLASCO

CHAPTER 5

The cash cycle

5.1. Introduction

We have looked at the cash balances and the working capital of the company in *Chapters 2* and *3*. We have discussed the relationship between the current assets and current liabilities in *Chapter 4*. We have seen that the situation has changed from year to year, and in fact, it changed not only from year to year but also from day to day as the company was conducting its business.

The cash was turning around in the business on a continuing basis. It was used to purchase inventory, to pay the invoices to suppliers, and when service was provided, cash was collected from the customers (see Figure 5.1).
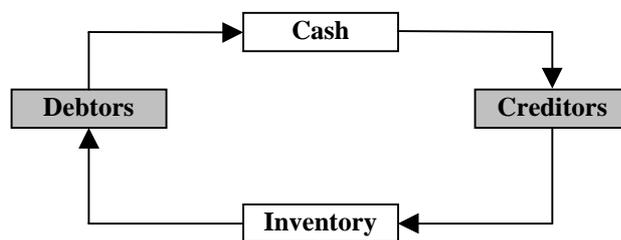
Figure 5.1: The cash cycle

Source: KLASCO

On each turn of the cycle the company was making a profit. The services were sold, hopefully, for more than the cost of their production, resulting in more cash available to expand the business.

One thing, which we didn't consider in detail in our prior analysis, was that most transactions were done on credit and it means the time element was involved. The company as a buyer almost always had a short period of time before it paid its suppliers for goods and services. The company as a seller almost always had to wait before the customers would make their payments.

Therefore, in this chapter we will look at the length of time that it took for the company to convert cash outflows into cash inflows. We will do this by analysing how the cash was flowing around the business in the cash or working capital cycle. For the ease of the investigation we will divide the cycle into three sub-cycles:
• inventory cycle
• accounts receivable cycle
• accounts payable cycle

The analysis, should allow us to determine the amount of capital the company needed to operate, and show how efficient it was in using credit and accounts receivable collection policies to support the business.

We will start the analysis by looking at the average daily sales and average daily costs, which will be used later as key dominators in calculating the inventory, accounts receivable, and accounts payable cycles.

5.2. Average daily sales and costs

The average daily sales and costs (hereinafter referred as ADS and ADC) are useful indicators of the company's short-term cash flows and financial position. They give a broad idea of how much more the company has received than it spent. The indicators are calculated by dividing sales and cost of sales that reflected in the year end financial statements of the company by the number of days in a year.

For the calculations some accounting books recommend to use a number of 240 days (working days in the year), some - 360 days (30 days per month x 12 months), others - 365 as a dominator (Vause, 1999, p.177). In our case we have used 365 days a year.

Now, let us look at the figures (see Table 5.1).

Table 5.1: Average daily sales and costs (1996 - 1998)

Item \Years	1996	1997	1998
Total sales (Lt.)	182.908.238	179.437.517	163.831.390
Total costs (Lt.)	157.395.758	156.497.778	149.619.941
ADS (Lt.)	**501.118**	**491.610**	**448.853**
ADC (Lt.)	**431.221**	**428.761**	**409.918**

Source: KLASCO

As we can see in the year 1996 the ADS was 501.118 Lt. and the ADC - 431.221 Lt. In the following years the figures have slightly declined, but not very much (see Figure 5.2.). It indicates that during the analysed three-year period the company had quite consistent cash inflows and outflows.
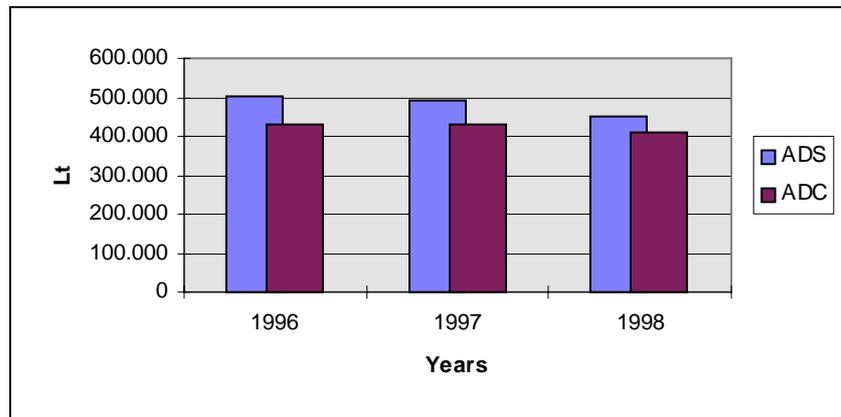
Figure 5.2: Changes in the average daily sales and costs (1996 - 1998)

Source: KLASCO

Combined with the other information from the balance sheet, the ADS and ADC will now help us to understand the way the cash was flowing around the business.

Let us start from looking at the inventory cycle.

5.3. Inventory cycle

The inventory cycle measures the length of time it took for the business to convert inventory into cost of sales. It represents the number of days the cash was tied up in inventory.

The way to calculate the length of time it took to convert inventory into cost of sales is by dividing the year-end balance figure for the inventory by the ADC. The ADC is used because inventory is valued at the net realisable value, so there is no profit element involved:

Days' inventory = Inventory/ ADC.

In general, the lower the number of days received from the equation, the better it is for the company. It means less financial resources were tied up in a non-profit-generating item. Besides, the inventory is expensive to keep. Bigger stocks would require large warehouses, more people employed and then would be more chances for the stock to become obsolete, damaged or even stolen. However, a too small number of days received from the equation might indicate that the company did not have a sufficient inventory level, and it could mean problems in satisfying needs of customers.

Now, let us consider the situation with KLASCO.

Table 5.2. Number of days the inventory was held (1996 - 1998).

Item \Year	1996	1997	1998
Inventory (Lt.)	28.513.114	29.499.042	28.312.616
ADC (Lt.)	431.221	428.761	409.918
Inventory held (d.)	**66**	**69**	**69**

Source: KLASCO

As we can see, during the analysed period, on average, the company was turning over the value of its entire stock every 66 - 69 days. The figures are quite stable. It shows that the company had more or less stable demand and consumption of the inventory. Nevertheless, an increase in a number of days' the inventory was held in 1997 and 1998, shows that in comparison with 1996 the situation got worse. Although the difference of three days might look not very significant, it represents a need for additional assets equal to almost 1,3 million Lt. in the year 1997 and a little bit less in the year 1998.

If it would prove to be possible to reduce the level of inventory from 69 days back to the previous level of 66 days, not only would there be no need for the additional assets but the cash cycle would speed up, the profit margin would be achieved three days earlier and, consequently, more profit would be made in the year.

An alternative way to look at the efficiency of inventory levels is to calculate the inventory turnover for the year. In order to do that we will divide the annual cost of sales by year-end inventory:

Inventory turnover = Annual total costs/ Inventory.

For this ratio, the higher the resulting figure the more effective is a company's management of inventory. However, too high a result, again, might indicate an insufficient level of inventory.

Table 5.3. Inventory turnover ratio (1996 -1998)

Item \Year	1996	1997	1998
Total costs (Lt.)	157.395.758	156.497.778	149.619.941
Inventory (Lt.)	28.513.114	29.499.042	28.312.616
Inventory turnover ratio	**6**	**5**	**5**

Source: KLASCO

From Table 5.3 we see that the company's inventory turnover in 1996 was six times per year, in 1997 and 1998 – five times. Although the speed of the turnover has slowed down a little bit, it still seems to be quite a good result for a stevedoring company, bearing in mind the amounts of money involved.

In order to get an even deeper insight into KLASCO inventory management we will exclude the prepayments from the inventory and will break down the stock of the company into product groups. The key idea of such a move is to distinguish and pinpoint the areas, which might be considered problematic in terms of cash flows, and therefore, would require additional attention from the management.

The results are provided below (see Table 5.4).

Table 5.4. Number of days the stock was held (1996 - 1998)

Item \Year	1996	1997	1998
Raw materials (Lt.)	11.845.334	12.314.569	14.873.379
Package (Lt.)	16.052	21.893	25.938
Fuel and oil products (Lt.)	606.878	601.163	456.051
Building materials (Lt.)	5.000.765	4.463.063	0
Spare parts (Lt.)	10.860.945	11.656.535	12.314.113
ADC (Lt.)	**431.221**	**428.761**	**409.918**
Raw materials (d.)	**27**	**29**	**36**
Package (d.)	**0,04**	**0,05**	**0,06**
Fuel and oil products (d.)	**1**	**1**	**1**
Building materials (d.)	**12**	**10**	**0**
Spare parts (d.)	**25**	**27**	**30**

Source: KLASCO

The analysis reveals that the company has no big need for package, and has no problems with the fuel and oil products supply. The stock was kept just to satisfy daily operational needs.

The need for raw materials was increasing each year but at the same time it was decreasing for building materials. It is interesting to notice that the amount of raw materials has increased almost exactly by the amount that building materials have decreased. It is difficult to say if there is any correlation between these two elements. It might be that in the year 1998 the building materials were accounted for raw materials. Therefore, it is hard to evaluate the increase in the level of raw materials. Nevertheless, proactive management and supply chain revision, probably, would prove it possible to reduce the raw materials to a level more beneficial for the company.

The stock of spare parts had also increased. It went from 25 to 30 days during the analysed period. This increase might be a signal that the equipment of the company was becoming obsolete, but again, in order to be sure, a detailed analysis of the equipment maintenance should be done.

5.4. Accounts receivable cycle

This cycle measures the length of time it took for the business to convert a sale of services into cash. Such knowledge is important because profits come only from paid sales.

The cycle is calculated by dividing the total year-end figure of the trade debtors on the balance sheet by the average daily sales (ADS):

Days' credit given = Trade debtors/ ADS.

The longer the debtor period, the greater the risk that debts will turn out to be bad debts, or will take considerable effort and cost to be collected. If the debtor period is lower the company is getting its cash back quicker and has the possibility to put it immediately in use. This is a crucial edge; to have cash returned earlier because the money that is not tied up in accounts receivable is a financial resource that can be used to expand the business.

Now let us look at the situation with KLASCO.

Table 5.5. Level of credit offered to customers (1996 - 1999)

Item \Years	1996	1997	1998
Trade debtors (Lt.)	13.624.062	20.999.426	22.381.817
ADS (Lt.)	501.118	491.610	448.853
Credit period offered to customers (d.)	27	43	50

Source: KLASCO

From table 5.5 we can see that in the year 1996 it took on average 27 days to collect money from the customers, in the year 1997 the credit period had grown to 43 days, and in the year 1998 to 50 days. This tells us that the situation was deteriorating.

Each year the company needed more and more financial resources to be employed in order to maintain its business.

The analysis made in *Chapter 4* (see Section 4.4) suggest that the company probably had enough money to afford long credit periods given to the customers, but the back side of such a policy is that late payments erode profits and, eventually, could lead to bad debts.

In order to have a complete picture about the company's credit policies we will next look at the accounts payable cycle. Then, we will compare the credit given to the customers with the credit taken from the suppliers.

5.5. Accounts payable cycle

The company uses the balance sheet item *short-term trade creditors* to account for the short-term trading debts payable within one year. These debts represent the amount of money the enterprise owes to its suppliers for goods and services delivered during that year. The time, which it takes from receiving goods from the suppliers to paying for the goods, forms an account payable cycle. The way to measure the cycle and the length of time it took for the business to pay its accounts payable is calculated by dividing the total figure of the trade creditors on the balance sheet by the average daily cost (ADC):

Days' credit taken = Trade creditors/ ADC

If a company has good credit terms this ratio will be high. If a company pays earlier the figure will be lower.

The high ratio is good, provided it is high by choice - otherwise it would be an indication of inability to pay. It shows to what extent the company uses suppliers' money, usually interest-free, to finance its own operations. The careful approach to the trade creditors might allow enhancing the cash position of the company. Therefore, the management of business creditors should be considered just as important as the management of the trade debtors.

Now, let us look at the situation in KLASCO and how they managed their trade creditors.

Table 5.6. Days' credit taken from suppliers (1996 – 1998)

Item \Year	1996	1997	1998
Trade creditors (Lt.)	2.377.013	2.133.574	19.675.815
ADC (Lt.)	431.221	428.761	409.918
Credit taken (d.)	6	5	48

Source: KLASCO

As we can see from table 5.6., on average, in the year 1996 and 1997 the company was paying to its suppliers after every 5 - 6 days. In the year 1998 the situation has changed dramatically. In comparison with the previous years the credit taken from the suppliers has increased to 48 days. In money terms it had risen to almost 20 million Lt. This radical shift in figures again support the assumption made in *Chapter 2* (see sub-Section 2.2.1) that the company had revised its financial policies and took steps towards more aggressive and positive use of suppliers' money.

5.6. Trade debtors to trade creditors ratio

The examination of the company's accounts receivable and accounts payable cycles showed that the credit offered to the customers was continuously increasing. At the same time the credit taken from the suppliers had increased as well.

Now, for the full picture, let us compare the trade debtors of the company to the trade creditors. In order to do that we will use the debtors to creditors ratio:

Debtors to creditors ratio = Trade debtors/ Trade creditors.

Table 5.7. Debtors to creditors ratio (1996 - 1998)

Item \Years	1996	1997	1998
Trade debtors (Lt.)	13.624.062	20.999.426	22.381.817
Trade creditors (Lt.)	2.377.013	2.133.574	19.675.815
Debtors to creditors ratio	**5,73**	**9,84**	**1,14**

Source: KLASCO

What we can see is that in the year 1996 for every 100 units of credit taken from suppliers the company was extending 573 units of credit to its customers, in 1997 the figure went up to 984 units, and in 1998 it has dropped to 114 units (see Table 5.7).

Under normal circumstances this ratio should remain reasonably constant from year to year. The ups and downs indicate an absence of a clearness in the company's credit policy. The company was extending more credit to its customers than it, in turn, was able to take from its suppliers. Therefore, even though the company was profitable it was running down its cash resources.

However, comparing the situation in the year 1998 with the previous years it is possible to conclude that it improved. The company started to use the suppliers' financial resources more efficiently.

5.7. The cash cycle

We have analysed how the cash was cycling around the business. We have looked at the cash outflows into inventory, how the suppliers of the inventory were paid, how the cash from the inventory went into customers' hands and came back from the accounts receivable until, finally, the cycle was completed. Now we could combine

the three analysed cycles into one, to get the total cash or working capital cycle of the company.

This cycle is the sum of the sales and inventory cycles less the accounts payable cycle:

Cash cycle = days' inventory – days' trade creditors + days' trade debtors.

It represents the length of time it took for the business from spending money on purchases of inventories until the accounts receivable were collected from the sale of the services. The longer the cycle the more money the company needs to support its business operations.

The length of the cycle depends on a number of factors, such as the credit and collection policies of the business, its inventory management policies, credit rating and payment patterns. It is possible for the company to shorten its cash cycle by implementing or strengthening the policies and procedures in these mentioned areas and we have seen already that it was done.

Now, let us look in more detail, how changes in different working capital areas have affected the total business situation and the company's need for financial resources.

Table 5.8. The cash cycle (1996 - 1998)

Item \Year	1996	1997	1998
Inventory held (d.)	66	69	69
Credit taken (d.)	6	5	48
Credit given (d.)	27	43	50
Cash cycle (d.)	**88**	**107**	**71**

Source: KLASCO

The average cash cycle in the year 1996 was 88 days, in 1997 it increased to 107 days, but in 1998 it went down to 71 days (see Table 5.8). The increase in 1997 was

mainly due to the extended credit to the customers while the decrease in 1998 was due to increased delays in payments to the suppliers.

If we would look at the situation in 1998 closer, we would see that in that year the company was tying up its money into inventory for 69 days, then it waited for 50 days until the customers had paid for the services. Therefore the company needed to finance itself for 119 days, to cover inventory holding and credit extended to customers. In money terms it was almost 49 million Lt. (the figure is received by multiplying the number of days by the average daily cost). The delay in the payments had allowed the company to reduce the cash cycle from 119 days to 71 days. Therefore, instead of 49 million Lt. the company needed "only" 29 million Lt. and it was the lowest result for the whole analysed three-year period (see Table 5.9).

Table 5.9. The company's need for the working capital (1996 - 1998)

Item \Year	1996	1997	1998
ADC (Lt.)	431.221	428.761	409.918
Cash cycle (d.)	88	107	71
Need for the working capital (Lt.)	**37.859.846**	**45.680.275**	**29.077.122**

Source: KLASCO

5.8. Conclusions

The analysis made in this chapter shows that in the years 1996 and 1997 the company was extending much more credit to its customers then in turn was taking from its suppliers. Therefore, in that period the company needed a lot of financial resources in order to support its business operations.

In 1998 there is an obvious shift in the company's credit policies. Although its accounts receivable did continue to grow, the company's credit taken from suppliers increased tremendously. In 1998 it almost covered the customers debts (see Table

5.7). This move has allowed the requirement for the working capital to be reduced significantly.

The fact that the company's actual working capital (see Table 3.7) was much large than needed to support the business operations, indicates that further actions should be taken in order to improve the business situation even more. We will come back to this topic in the last chapter of the research.

CHAPTER 6

Funds flow statement analysis

6.1. Introduction

In previous chapters we have looked at different areas of the working capital of the company.

The change in cash balances, liquidity ratios, debtors to creditors ratio and others, clearly distinguished the year 1998 from the previous in the analysed period. However, we still miss some information in order to understand in full what has happened with the company before privatisation.

The problem of using working capital as the basis for analysing financial changes of the business is that it ignores other sections of the balance sheet, such as: changes in fixed assets, shareholders' funds and long term borrowings. There is more to the business than just the working capital cycle. Fixed assets are bought and sold, dividends, interest and tax paid, loans raised and repaid, shares issued and repurchased. It results in money inflows and outflows outside the area of working capital. When these items are included a better foundation is provided for the analysis of movements in the company's financial resources. It is called funds flow analysis.

Therefore, in order to have a full picture of the transformations the company was experiencing in the year 1998, we have to look at the funds flow statement. We will

produce the statement by comparing two consecutive balance sheets representing the years 1997 and 1998. The comparison will allow us to cover all financial movements during the last year before privatisation and it will take us to the final conclusions about the event.

We will start by defining the term "funds" and by looking at sources and uses of funds.

6.2. Sources of funds

Funds can be defined as any source of finance allowing the company to acquire assets. If the company is considering to make investments it can get funds from its:

- existing cash balances
- cash generated from operations
- capital raised from shareholders
- borrowed money
- changes in credit terms
- sale of assets

Sources of funds can be subdivided into two categories: internal and external. Internal sources are largely under the control of the company. These would be the ordinary profit stated within the income statement, money generated from selling of assets or from shareholders. External sources represent an increase in liabilities and consist of suppliers giving credit payment terms to the company and banks and other institutions providing short, medium or long term finance.

Sources of funds to the business are expressed in the equation:

Sources = increase in liabilities and/or decreases in assets

6.3. Uses of funds

The funds available to the company during the year can be used for:

- increasing current assets
- decreasing current liabilities
- purchasing fixed assets
- repaying borrowings
- repurchasing shares
- covering operating losses

As we can see, an increase in the value of assets or a decrease in a liability, such as the purchase of a new machine, payments to suppliers or the repayment of a loan, can be assumed to have consumed funds. Therefore, we could express uses in an equation:

Uses = increases in assets and/ or decreases in liabilities

The balance sheet is the starting point for discovering what funds have been generated during the year and how these have been used in the business. The balance sheet equation *assets = liabilities* ensures that in any year the company cannot use more funds than it generates or generate more than it uses; in other words *sources = uses*. If more funds are generated than can be immediately used for operational purposes, such as paying interest and dividends or repaying borrowings, the surplus will appear in the year-end cash balances. Holding more cash is a use of funds.

Now let us produce a fund flow statement for KLASCO and let us consider the sources and uses of the funds the company had in the analysed period.

6.4. The funds flow statement

We already mentioned that we will concentrate our attention on the year 1998, when the biggest changes took place in the company. In order to produce the funds flow statement for that period we will compare two consecutive balance sheets representing the years 1997 and 1998. The difference between these two balance sheets will show as increases and decreases in assets and liabilities of the company. All changes that have occurred during the year are thus identified as representing a source or a use of funds for the business.

For the ease of the analysis we will present the fund flow statement in six separate sections. In the first section of the comparative statement we look at the changes in the company's assets in general. The second and the third sections will be used to analyse these changes in more detail. The fourth section will deal with the changes in equity and liabilities in general. The fifth and sixth – will be used for a deeper analysis of these changes.

6.4.1. Changes in the company's assets in general

From table 6.1 we can see that in a period between the year 1997 and 1998 company's fixed assets had increased by almost 30%. At the same time short-term assets had declined by almost 18%. Here, an increase in the company's fixed assets represents use of funds, decrease in the current assets - source of funds.

Table 6.1: Changes in the company's assets (1997 – 1998)

No.	Item \Year	1997	1998	Increase \Decrease	
		Lt.	Lt.	Lt.	%
A.	Long term assets	236,067,314	306,237,270	70,169,956	29.7%
B.	Short term assets	106,237,633	87,265,713	-18,971,920	-17.9%
A+B	**Total assets**	**342,304,947**	**393,502,983**	**51,198,036**	**15.0%**

Source: KLASCO

Although it is not unusual for companies which are in the cargo handling business to have big investments, nevertheless an increase during one year by 30% in long term assets is not an ordinary event in the company's life. It signifies a growth of the business, a move towards bigger cargo handling capacities and eventually an attempt to capture larger market share.

Now, it is a well-known fact that during the analysed period the company had invested into a new container terminal. This container terminal was officially opened in January 1999, and it is the first modern container terminal in the three ex-USSR Baltic countries.

6.4.2. Changes in the company's long-term assets

The second section of the funds flow statement shows the changes in the company's long-term assets in detail. It discloses the actual distribution of the investments (see Table 6.2). This information was not showed in the cash flow statement.

As we can see, the major expenses had been registered in the tangible assets area. In comparison with the previous fiscal period the value of the machinery in the company's possession had increased by more than 57 million Lt., and the worth of the buildings by 19 million Lt.. It is interesting to notice that the formation costs, which are associated with the future development or reorganisation of the enterprise, had increased as well. In fact, they increased very much, almost 10 times. It means that efforts were made, not only to enhance the company's opportunities in a market, but also to revise and strengthen the enterprise from inside.

Table 6.2: Changes in long-term assets (1997 – 1998)

No.	Item \Year	1997	1998	Increase \Decrease	
		Lt.	**Lt.**	**Lt.**	**%**
A.	**Long term assets**	**236,067,314**	**306,237,270**	**70,169,956**	**29.7%**
I.	**Formation costs**	**146,388**	**2,936,717**	**2,790,329**	**1906.1%**
I.1.	Cost of formation and capital increase	--------	-------	-------	-------
I.2.	Loan issue costs	--------	-------	-------	-------
I.3.	Other formation costs	146,388	2,936,717		
I.4.	Reorganization costs	-------	-------	-------	-------
II.	**Intangible assets**	**312,146**	**132,396**	**-179,750**	**-57.6%**
II.1.	Research and development costs	--------	-------	-------	-------
II.2.	Rights obtained	312,146	132,396	-179,750	-57.6%
II.3.	Goodwill	-------	-------	-------	-------
II.4.	Prepaid expenses	-------	-------	-------	-------
III.	**Tangible assets**	**204,762,644**	**270,693,594**	**65,930,950**	**32.2%**
III.1.	Land	--------	-------	-------	-------
III.2.	Buildings	35,024,388	54,044,882	19,020,494	54.3%
III.3.	Plant and machinery	126,258,638	183,578,533	57,319,895	45.4%
III.4.	Vehicles and other transport means	21,741,991	20,254,764	-1,487,227	-6.8%
III.5.	Other fixtures, fittings, tools and equipment	3,178,526	3,043,516	-135,010	-4.2%
III.6.	Leasing and similar rights	-------	-------	-------	-------
III.7.	Other tangible assets	244,469	1,481,021		
III.8.	Constructions in progress and prepayments	18,314,632	8,290,878	-10,023,754	-54.7%
IV.	**Financial long term assets**	**7,373,403**	**8,014,787**	**641,384**	**8.7%**
IV.1.	Enterprises in which participation interest is held	--------	-------	-------	-------
IV.1.1.	Investments	--------	-------	-------	-------
IV.1.2.	Amounts receivable	--------	-------	-------	-------
IV.2.	Other financial long term assets	7,373,403	8,014,787	641,384	8.7%
IV.2.1.	Own shares	--------	-------	-------	-------
IV.2.2.	Other investments	7,373,403	8,014,787	641,384	8.7%
IV.2.3.	Other amounts receivable	--------	-------	-------	-------
V.	**Amounts receivable after one year**	**23,472,733**	**24,459,776**	**987,043**	**4.2%**
V.1.	Trade debtors	--------	-------	--------	-------
V.2.	Other amounts receivable	23,472,733	24,459,776	987,043	4.2%

Source: KLASCO

6.4.3. Changes in the company's short-term assets

The third section of the funds flow statement shows changes in the short-term or current assets of the firm. We can see that they declined during the analysed year (see Table 6.3) and in this case they represent sources of funds.

Table 6.3. Changes in short-term assets (1997 – 1998)

No.	Item \Year	1997	1998	Increase \Decrease	
		Lt.	Lt.	Lt.	%
B.	**Short term assets**	**106,237,633**	**87,265,713**	**-18,971,920**	**-17.9%**
I.	**Stocks and contracts in progress**	**29,499,042**	**28,312,616**	**-1,186,426**	**-4.0%**
I.1.	Stocks	29,499,042	28,312,616	-1,186,426	-4.0%
I.1.1.	Raw materials and consumables	29,172,282	27,669,484	-1,502,798	-5.2%
I.1.2.	Work in progress	--------	-------	-------	-------
I.1.3.	Finished products	--------	-------	-------	-------
I.1.4.	Immovable property intended for resale	--------	-------	-------	-------
I.1.5.	Goods purchased for resale	--------	-------	-------	-------
I.1.6.	Prepayments	326,760	643,132	316,372	96.8%
I.2.	Contracts in progress	--------	-------	-------	-------
II.	**Amounts receivable within one year**	**41,374,807**	**39,702,931**	**-1,671,876**	**-4.0%**
II.1.	Trade debtors	20,999,426	22,381,817	1,382,391	6.6%
II.2.	Other amounts receivable	20,375,381	17,321,114	-3,054,267	-15.0%
II.2.1.	Called-up capital unpaid	--------	-------	-------	-------
II.2.2.	Other debtors	20,375,381	17,321,114	-3,054,267	-15.0%
III.	**Investments and other term deposits**	**--------**	**-------**	**-------**	**-------**
III.1.	Own shares	--------	-------	-------	-------
III.2.	Other investments and term deposits	--------	-------	-------	-------
IV.	**Cash at bank and in hand**	**35,363,784**	**19,250,166**	**-16,113,618**	**-45.6%**
C.	**Accrued income and deferred charges**	**--------**	**-------**	**-------**	**-------**

Source: KLASCO

The main area of decline in the current assets was cash balances, which decreased by 16 millions. Although, it is a substantial amount of money, nevertheless, it was not enough to satisfy the company's investment need. Therefore, the business needed additional sources of finance. These can be found by looking at the liability side of the balance sheet, which is presented in the following funds flow statement sections.

6.4.4. Changes in equity and liabilities

This section represents changes in the owners' equity and liabilities (see Table 6.4.).

Table 6.4: Changes in equity and liabilities (1997 – 1998)

No.	Item \Year	1997	1998	Increase \Decrease	
		Lt.	Lt.	Lt.	%
A.	Capital and reserves	326,769,091	326,515,516	-253,575	-0.1%
B.	Financing (grants and subsidies)	--------	--------	--------	--------
C.	Provisions for liabilities and charges, postponed and deferred taxes	--------	--------	--------	--------
D.	Amounts payable and liabilities	15,535,856	66,987,467	51,451,611	331.2%
E.	Accrued charges and deferred income	--------	--------	--------	--------
A+B+C+D+E	Total owners' equity and liabilities	342,304,947	393,502,983	51,198,036	15.0%

Source: KLASCO

As we can see the amounts payable and liabilities of the company had increased significantly through the year 1998. They went up by 331,2% and in money terms it was almost 51 million Lt.. The capital and reserves had decreased, but not very much, just by 0,1% or around 254 thousand Lt.. In this case the increase in amounts payable is considered as a source of funds, the decrease in capital and reserves as use of funds. However, it is necessary to be careful in appraising the decrease of reserves as the use of the funds. Therefore, let us consider the changes in capital and reserves in more detail.

6.4.5. Changes in the capital and reserves

Reserves are retained profits, which have been set aside. As we can see (see Appendix 2), the balance sheet distinguishes three types of the reserves: legal, available for distribution, and not available for distribution. Legal reserves could be used only in cases provided by law. They are not available for the company's development and usually stay unchanged for a long time. Therefore, we see no changes in that item. Reserves available for distribution can be used for paying dividends. Therefore, the decrease in these reserves could be considered as a decrease of liabilities that the company has against its shareholders and it means use of funds. We see from Table 6.5 that reserves available for distribution had decreased by 4,3 million Lt.

Reserves not available for distribution usually represent financial resources set aside for a company's future development. Therefore, they could be considered as a source of funds. In order to use these reserves, Lithuanian laws require the decision to be taken by two thirds of the shareholders' votes. As we can see, these reserves had decreased by 5,8 million Lt.

Table 6.5: Changes in capital and reserves (1997 – 1998)

No.	Item \Year	1997	1998	Increase \Decrease	
		Lt.	**Lt.**	**Lt.**	**%**
A.	**Capital and reserves**	**326,769,091**	**326,515,516**	**-253,575**	**-0.1%**
I.	**Capital**	**128,988,800**	**128,988,800**	**0**	**0.0%**
I.1.	Subscribed capital	128,988,800	128,988,800	0	0.0%
I.2.	Uncalled capital	--------	--------	--------	--------
II.	**Share premium account**	--------	--------	--------	--------
III.	**Revaluation reserve**	**7,430**	**7,430**	**0**	**0.0%**
IV.	**Reserves**	**197,772,861**	**187,654,456**	**-10,118,405**	**-5.1%**
IV.1.	Legal reserve	12,898,880	12,898,880	0	0.0%
IV.2.	Reserves not available for distribution	135,309,874	129,495,142	-5,814,732	-4.3%
IV.3.	Reserves available for distribution	49,564,107	45,260,434	-4,303,673	-8.7%
V.	**Profit (loss) brought forward**	--------	**9,864,830**	**9,864,830**	--------
V.1.	Profit (loss) of the current year	--------	9,864,830	9,864,831	--------
V.2.	Profit (loss) of the previous year	--------	--------	--------	--------
B.	**Financing (grants and subsidies)**	--------	--------	--------	--------
C.	**Provisions for liabilities and charges, postponed and deferred taxes**	--------	--------	--------	--------
I.	**Provisions**	--------	--------	--------	--------
I.1.	For pensions and similar obligations	--------	--------	--------	--------
I.2.	For tax charges	--------	--------	--------	--------
I.2.1.	Unexpected	--------	--------	--------	--------
I.2.2.	Others	--------	--------	--------	--------
I.3.	Major repairs and large-scale maintenance	--------	--------	--------	--------
I.4.	Other provisions	--------	--------	--------	--------
II.	**Postponed taxes**	--------	--------	--------	--------
II.1.	On subsidies in capital	--------	--------	--------	--------
II.2.	Others	--------	--------	--------	--------

Source: KLASCO

One more source of funds presented in the fifth section of the funds flow statement is retained profit, which in the year 1998 was around 10 million Lt.

6.4.6. Changes in long-term and short-term liabilities

The last part of the funds flow statement reflects changes in long-term and short-term liabilities of the company (see Table 6.6).

Table 6.6: Changes in liabilities (1997 – 1998)

No.	Item \Year	1997	1998	Increase \Decrease	
		Lt.	Lt.	Lt.	%
D.	**Amounts payable and liabilities**	**15,535,856**	**66,987,467**	**51,451,611**	**331.2%**
I.	**Amounts payable after one year and long term liabilities**	**7,500,000**	**43,592,480**	**36,092,480**	**481.2%**
I.1.	Financial debts	7,500,000	43,592,480	36,092,480	481.2%
I.1.1.	Subordinated loans	--------	--------	--------	--------
I.1.2.	Unsuborinated loans	--------	--------	--------	--------
I.1.3.	Leasing and other similar obligations	--------	1,692,480	1,692,480	--------
I.1.4.	Credit institutions	7,500,000	41,900,000	34,400,000	458.7%
I.1.5.	Others	--------	--------	--------	--------
I.2.	Trade creditors	--------	--------	--------	--------
I.2.1.	Suppliers	--------	--------	--------	--------
I.2.2.	Bills of exchange payable	--------	--------	--------	--------
I.3.	Prepayments received on contracts in progress	--------	--------	--------	--------
I.4.	Other amounts payable and long-term liabilities	--------	--------	--------	--------
II.	**Amounts payable within one year and short-term liabilities**	**8,035,856**	**23,394,987**	**15,359,131**	**191.1%**
II.1.	Short term proportions of long term debts	--------	--------	--------	--------
II.2.	Financial debts	--------	--------	--------	--------
II.2.1.	Credit institutions	--------	--------	--------	--------
II.2.2.	Other loans	--------	--------	--------	--------
II.3.	Trade creditors	2,133,574	19,675,815	17,542,241	822.2%
II.3.1.	Suppliers	2,133,574	19,675,815	17,542,241	822.2%
II.3.2.	Bills of exchange payable	--------	--------	--------	--------
II.4.	Prepayments received on contracts in progress	--------	--------	--------	--------
II.5.	Taxes, remuneration and social security payable	1,875,360	1,660,431	-214,929	-11.5%
II.5.1.	Taxes	127,814	174,535	46,721	36.6%
II.5.2.	Remuneration	1,747,546	1,485,896	-261,650	-15.0%
II.5.3.	Social security payable	--------	--------	--------	--------
II.6.	Other amounts payable and short-term liabilities	4,026,922	2,058,741	-1,968,181	-48.9%
E.	**Accrued charges and deferred income**	--------	--------	--------	--------

Source: KLASCO

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We can see that the company's long-term financial debts had increased by 36 million Lt.. Additionally 15,3 million Lt. was generated from the increase in the short-term liabilities. These two sources together with the cash balances are the main sources, from which the company obtained money for its investments.

6.5. Comparison of sources and uses of funds

In order to test our assumptions about the sources and the uses of funds we have to compare them. If the assumptions are right, sources should be equal to uses.

Table 6.7: Sources and uses of the funds in the year 1998

Sources of funds	Lt.	Uses of funds	Lt.
Decrease in intangible assets:	--------	**Increase in intangible assets:**	--------
Rights obtained	179,750	Formation costs	2,790,329
Decrease in tangible assets:	--------	**Increase in tangible assets:**	----------------
Vehicles and other transport means	1,487,227	Buildings	19,020,494
Other fixtures, fittings, tools and equipment	135,010	Plant and machinery	57,319,895
Constructions in progress and prepayments	10,023,754	Other tangible assets	1,236,552
Decrease in stocks and contracts in progress:	--------	**Increase in financial long term assets**	**641,384**
Raw materials and consumables	1,502,798	**Increase in amounts receivable after one year**	**987,043**
Decrease in amounts receivable within one year:	--------	**Increase in stocks and contracts in progress:**	--------
Other debtors	3,054,267	Prepayments	316,372
Decrease in cash at bank and in hand	**16,113,618**	**Increase in amounts receivable within one year:**	--------
Retained profit	**9,864,830**	Trade debtors	1,382,391
Increase in amounts payable after one year and long term liabilities:	--------	**Decrease in reserves:**	--------
Leasing and other similar obligations	1,692,480	Reserves not available for distribution	5,814,732
Credit institutions	34,400,000	Reserves available for distribution	4,303,673
Increase in amounts payable within one year and short-term liabilities:	--------	**Decrease in amounts payable within one year and short-term liabilities:**	--------
Suppliers	17,542,241	Remuneration	261,650
Taxes	46,721	Other amounts payable and short-term liabilities	1,968,181
Total sources of funds	**96,042,696**	**Total uses of funds**	**96,042,696**

Source: KLASCO

Table 6.7 shows that we were right. Sources match the uses of funds as they are supposed to do.

6.6. Conclusions

The funds flow statement analysis reveals the main sources of funds which were available to the company during the analysed period. It also shows how these funds were used.

It is interesting to notice that the last year before the privatisation formation costs of the company increased almost 10 times. It means that not only the efficiency of the company's financial resource management has improved, but also the money was spent to improve the company from inside and therefore, to make it more attractive to the potential investor.

Another interesting point is that during the analysed period the company had very large reserves (see Table 6.5, line IV) but did not use them. This fact seems to be quite strange. However, the author thinks that it was done on purpose in order to keep the price of the enterprise before the privatisation on a highest possible level. If the company had made capital investments entirely from its own reserves the total assets of the company would be lower. The loan increased the total assets of the company, hence price of the company and put the debt on future owner's shoulders.

CHAPTER 7

Conclusions

7.1. Overview of the study

This is a final chapter of the study. Here the author makes an overview of the research, sum-ups all his findings, draw conclusions and provides the recommendations.

The aim of the research was to show how the financial resource management and in particular, cash flow management could change the business situation - reduce the amount of capital needed to support operations, reduce need for the external financing through the increase in cash flows from operating activities, consequently reduce operating costs, hence increase the competitiveness.

The study was divided into seven parts-chapters. The first part gives a general introduction into the subject. *Chapter 2* examines Klaipėda Stevedoring Company's cash balances. In *Chapter 3* the analysis expands to cover all current assets and current liabilities of the company. *Chapter 4* assesses changes in the liquidity. In *Chapter 5* the cash cycle and the company's credit policies are studied. The *sixth chapter* makes a comparative analysis of the 1997 and 1998 balance sheets. The last chapter draws conclusions about the efficiency of the financial resource management in the company; points out to the actions which were undertaken by the management;

gives final assessment of the adequacy of size of the cash balances and working capital; provides with the recommendations.

7.2. Assessment of the financial resource management in the company

The analysis of KLASCO financial statements for the years 1996 and 1997 allows to conclude that the financial resource management at that time was poor. This statement is supported by the following facts:

- The company's net cash flow from operating activities was rapidly declining. During one year it went down from 23 million Lt. to just 12 million Lt. (see Table 2.1). The main reason to that was sharp increase in the trade receivables.
- Despite the fact that the company's self financing capability in 1997 was almost 3 times bigger than its need for capital expenditures (see Table 2.4), the loan was taken.
- The data that disclosed in the cash flow statement (see Table 2.3) allows assuming that almost 60% of the loan may have been used to pay dividends.
- The substantial part of the accounts receivable in 1996 and in 1997 (37,9 million Lt. and 20,3 million Lt., respectively) were other than trade accounts receivable (see Table 3.2).
- The level of the trade creditors was extremely low - just 2,3 and 2,1 million Lt., respectively (see Table 3.4).
- The liquidity of the company was very high, mainly due to the large amounts receivable. The current and liquid ratios were going up (see Table 4.1 and Table 4.3).
- The company was extending more credit to its customers than it, in turn was taking in credit from its suppliers (see Table 5.7).

- The cash cycle was increasing (see Table 5.8) and the need for the working capital to support the operations went up from 37,8 to 45,6 million Lt. (see Table 5.9).

In 1998 the financial situation of the company has improved dramatically. Distinctive features of that period are:

- A tremendous increase in the net cash flow from operating activities. From 12 million Lt. in 1997 it went up to more than 60 million Lt. in 1998 (see Table 2.1). Basically it was achieved through the increase in the trade payables and decrease in the prepayments of the company.
- The amount of the working capital employed in operations has gone down. In 1998 in order to increase the turnover by one million Lt. the company needed almost 100 thousand Lt. less than it was in two previous years (see Table 3.8).
- The liquidity ratios were reduced and were approaching more or less reasonable levels (see Figure 4.2)
- The company started to use suppliers' financial resources more aggressively. This provided an additional, interest-free, source of the cash for the company.
- The credit provided to the customers was almost fully covered by the credit taken from the suppliers (see Table 5.7).
- The cash cycle of the company became shorter. It has been reduced from 107 days to 71 day (see Table 5.8), which means that the turnaround of the company's cash resources speeded up. Less working capital was needed to support the business operations (see Table 5.9), and what is most important - the profit margin was received 36 days earlier.

Summing up the changes in the company's financial position during the last year before the privatisation, we could say that there were obvious actions taken by the management of the company at that time to improve the utilisation of financial

resources. Hence, to make the company more attractive and more expensive before the privatisation.

First of all, the management of the company increased the accounts payable and used them to finance the necessary business transactions. Use of the suppliers' financial resources increased the profitability of the business and allowed the requirement for the working capital to be reduced significantly.

Second, the moneys were spent to improve the company from inside. It is reflected in the balance under the heading *formation costs*.

Third, the investment into long-term assets was made, which automatically increased the price of the enterprise.

Fourth, in order to keep the price of the company on a high level, the investments into long-term assets were made not from the reserves of the company, but from the loans.

Fifth, in order to demonstrate that the company is profitable, two years in a row it was paying comparatively large dividends to its shareholders.

Although it is obvious that the measures taken in the year 1998 had improved the company's financial situation significantly, in order to understand how successful the management of the company was and what areas still should be targeted we have to look at the remaining cash balances and working capital at the end of 1998.

7.2.1. Assessment of the company's cash position

The analysis of the cash flow statement made in *Chapter 2* have shown us that at the end of the analysed period the company's cash balances was 19,2 million Lt.. If we would divide this figure by the ADC we would get the ratio that is called defensive interval of the company (Vause, 1999, p. 185).

This ratio assumes that the company, for whatever reason, ceases to have any cash inflows or sources of credit and its survival depends entirely to the length of time that existing cash balances could support operations.

Table 7.1: Defensive interval (1996 - 1997)

Item \Year	1996	1997	1998
Cash (Lt.)	30.020.478	35.363.784	19.250.166
ADC (Lt.)	431.221	428.761	409.918
Defensive interval (d.)	**70**	**82**	**47**

Source: KLASCO

As we can see from Table 7.1 the defensive interval of the company at the end of 1998 was 47 days.

Although the higher results in the two previous years shows that the company was able to survive without any cash inflows for a much long period then in 1998, and therefore might look as having been more efficient, the cash by itself is a worthless asset and long defensive interval indicates that the company had too much cash, and was not using it efficiently.

The result of 47 days still looks to be a little bit high, bearing in mind that the company had a very low gearing and therefore in case of emergency was able to obtain necessary funds from banks quite easily. However, in order to have a precise view about the company's need for cash, monthly cash inflows and outflows and

possible peaks of inflows and outflows per year should be examined. Unfortunately the author has no such possibility. Nevertheless he assumes that 19 million Lt. at the end of 1998, indicates that the company still had a cash surplus and did not use it efficiently enough.

7.2.2. Assessment of the company's need for the working capital

The company's working capital was examined in *Chapter 3*. The analyses of the current assets and current liabilities have shown that the total amount of working capital was declining. Therefore we raised a question whether the company was over-stretching its financial capabilities or not.

The analysis of the company's cash cycle made in *Chapter 5* provided us with the answer to this question. The company's need for the working was much lower then the actual amount of capital it had. One of the major reasons to that was a high level of other than trade accounts receivable. Therefore, the working capital area also should be considered as place where the future improvements should be made.

7.3. Recommendations

Although, the research shows that the financial resource management of the company has improved significantly, still, according to the author's opinion, there are some areas that should be improved.

First of all, the other accounts receivable should be reduced. It is not normal that big portion of the accounts receivable is associated with the other than trade debts. The author has information that this area was targeted in the year 1999 and that the other accounts receivable were reduced significantly.

Second, the concern should be raised about the continuously increasing stock of the spare parts. It might be a signal that the equipment used by the company is becoming obsolete.

Third, the company should start using its large reserves for its capital investment needs, of course provided that it is cheaper than loans.

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